INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Specification of errors to be urged	5
Summary of argument	6
Argument:	
The taxpayer's surrender of his debentures for cash constituted a retirement of the debentures within the meaning of Section 117 (f) of the Revenue Act of 1934 and the loss thereby sustained was a capital loss	9
Conclusion	33
Appendix	34

CITATIONS

Cases:	
Braun, Trustee v. *Commissioner*, 29 B. T. A. 1161	14, 15
Commissioner v. *Hammel*, No. 49, October Term, 1940	23
Commonwealth Commercial State Bank v. *Lucas*, 41 F. (2d) 111	27
Corbin v. *Commissioner*, 39 B. T. A. 1163	18, 29
Crooks v. *Harrelson*, 282 U. S. 55	31
Echols v. *Commissioner*, 61 F. (2d) 191	31
Electro-Chemical Engraving Co. v. *Commissioner*, No. 62, October Term, 1940	23
Empire Security Co. v. *Berry*, 211 Ill. App. 278	13
Fairbanks v. *United States*, 306 U. S. 436	11, 19
Ginsberg & Sons v. *Popkin*, 285 U. S. 204	29
Hellmich v. *Hellman*, 276 U. S. 233	29
Helvering v. *Weaver Co.*, 305 U. S. 293	23
Lebanon Nat. Bank v. *Commissioner*, 76 F. (2d) 792	27
McClain v. *Commissioner*, 110 F. (2d) 878, pending on writ of certiorari, No. 55, October Term, 1940	10, 13, 17, 18, 19
Missouri v. *Ross*, 299 U. S. 72	29
Old Colony Co. v. *Commissioner*, 301 U. S. 552	12
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552	12
Pacific Nat. Bank v. *Commissioner*, 91 F. (2d) 103	27
Powell v. *Kyle*, decided February 10, 1938, not officially reported, but found in 1938 C. C. H., Vol. 4, par. 9104	31

Cases—Continued. Page

Rockwell v. *New York United Hotels*, 79 F. (2d) 81, certiorari, denied, *sub nom. Donahue* v. *Rockwell*, 296 U. S. 650 ---- 4
United States v. *Chase*, 135 U. S. 255 ---- 29
United States v. *Fairbanks*, 95 F. (2d) 794, affirmed, 306 U. S. 436 ---- 14
Watson v. *Commissioner*, 27 B. T. A. 463 ---- 14, 15, 16
Werner v. *Commissioner*, 15 B. T. A. 482 ---- 16
White v. *United States*, 305 U. S. 281 ---- 23, 31, 32
Woolford Realty Co. v. *Rose*, 286 U. S. 319 ---- 12

Statutes:

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 541, Sec. 216, as amended by act of June 22, 1938, c. 275, 52 Stat. 840 ---- 14
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 208 ---- 11
Revenue Act of 1928, c. 852, 45 Stat. 791:
Sec. 101 ---- 11
Secs. 201, 208 ---- 31
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 101 ---- 20
Revenue Act of 1934, c. 277, 48 Stat. 680:
Sec. 23 (U. S. C., Title 26, Sec. 23) ---- 12, 29, 32, 34
Sec. 117 (U. S. C., Title 26, Sec. 101) ---- 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 25, 26, 28, 29, 30, 31, 32, 34
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 117 ---- 30
Revenue Act of 1938, c. 289, 52 Stat. 447:
Sec. 23 ---- 8, 24, 25
Sec. 117 ---- 25, 26

Miscellaneous:

Century Dictionary and Cyclopedia (Revised Ed.), Vol. VIII, p. 5123 ---- 13
Cong. Record, Vol. 78, Part 6, p. 5846 ---- 21
H. Conference Rep. No. 2330, 75th Cong., 3d Sess., p. 35 ---- 24
House Hearings before Ways and Means Committee on Revenue Revision, 1934, 73d Cong., 2d Sess., pp. 190–191 ---- 15
H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10 ---- 15, 20
pp. 30–32 ---- 20
I. T. 2986, XV–1 Cum. Bull. 136 ---- 30
I. T. 3121, 1937–2 Cum. Bull. 138 ---- 30
Report of Subcommittee of Committee on Ways and Means on a Proposed Revision of the Revenue Laws, 75th Cong., 3d Sess., pp. 44–46 ---- 25
Senate Hearings before Finance Committee on H. R. 1, 70th Cong., 1st Sess., pp. 295, 297 ---- 15
S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11–13 ---- 15
Treasury Regulations 77, promulgated under the Revenue Act of 1932, Art. 191 ---- 28

Miscellaneous—Continued.

	Page
Treasury Regulations 86, promulgated under the Revenue Act of 1934:	
Art. 23 (k)–1	26
Art. 23 (k)–3	27
Art. 23 (k)–4	27, 28, 36
Art. 117–4	37
Treasury Regulations 101, promulgated under the Revenue Act of 1938, Art. 23 (k)–4	25
Webster's New International Dictionary (1939 Ed.), p. 2128	12

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 58

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

S. C. THOMSON

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 6–9) is reported in 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 40–41) is reported in 108 F. (2d) 642.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 41–42). The petition for a writ of certiorari was filed April 25, 1940, and was granted May 20, 1940 (R. 42). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer owned corporate debentures. Pursuant to a court order approving a plan of reorganization of the corporation, the taxpayer surrendered his debentures and received a small part of their face value in full payment. The question presented is whether the deductibility of the resulting loss is subject to the limitations upon capital losses contained in Section 117 (d) of the Revenue Act of 1934. The answer to this question, in turn, depends upon whether the discharge of the debentures constituted a "retirement" thereof within the meaning of Section 117 (f) of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations involved will be found in the Appendix, *infra*, pp. 34–37.

STATEMENT

The facts as stipulated (R. 13–38) and as found by the Board of Tax Appeals (R. 6–9) are substantially as follows:

In May 1927 the taxpayer, a resident of New York, purchased twenty-year 6% sinking-fund gold debentures of the New York United Hotels, Incorporated, maturing February 1, 1947, having a total face value of $25,000 for which he paid $24,750. The debentures were subject to redemption at a premium by the debtor at any time after notice of thirty days (R. 6, 13).

In 1931 the debtor corporation encountered financial difficulties and the debenture holders consented to a plan of readjustment whereby, on certain conditions, they consented to a reduction in and postponement of payment of interest (R. 6, 13, 16–17).[1]

On December 15, 1933, ancillary receivers were appointed by the United States District Court for the Southern District of New York, and a plan to reorganize the debtor corporation was submitted to the court[2] (R. 6, 13, 15–24).

---

[1] The corporation had debentures of $5,113,500 outstanding (R. 15). Holders of debentures in the amount of $4,551,500 agreed to the plan (R. 17).

[2] The plan contemplated a sale of the assets of the corporation to a new corporation and permitted the debenture holders to purchase for cash at par plus accrued interest debentures to be issued by the new corporation having a face value equal to 1/100 of the face value of the old debentures (R. 23). Upon purchase of the new debentures and surrender of the old the debenture holder was also entitled to receive with each $10 face value of new debentures five shares of preferred stock of the new company and a voting trust certificate for five shares of common stock of the new company (R. 23). A debenture holder who did not purchase any new debentures was entitled to receive a voting trust certificate for two and one-half shares of common stock for each $1,000 debenture surrendered (R. 23). The plan was subsequently modified in some respects when the new company, Roosevelt Hotel, Incorporated, changed the offer concerning the purchase of the assets of the debtor (R. 25–26, 29). On March 8, 1934, the court entered an order (R. 27–32), approving the plan of reorganization, although there was no provision for debenture holders who did not participate in the plan of reorganization (R. 6, 14, 23).

On May 22, 1934, the court entered its final order in the reorganization proceedings (R. 33–36).[3] The court order discloses that the receivers were directed to pay over certain funds to the debtor's landlord on the condition that the latter agree to turn over to the new corporation amounts sufficient to pay the debenture holders $5 for each $1,000 face amount of the debentures upon surrender of the debentures with all coupons attached (R. 35–36). The receivers were then discharged and the new corporation accepted the surrender of the debentures and paid the debenture holders (R. 37–38).[4] Pursuant to the order of the court the taxpayer received a written notice which stated that the debtor corporation's assets had been sold, and that he was entitled to receive $5 for each $1,000 face amount of his debentures upon surrendering them to the Roosevelt Hotel, Incorporated, with all interest coupons attached, on or before August 20, 1934 (R. 6, 14, 37–38). It was stated that the payment so made would be in full payment and settlement of said debentures (R. 6, 14, 38). The taxpayer surrendered his debentures (for which he had paid

---

[3] The decision of the District Court approving the plan was upheld by the Circuit Court of Appeals for the Second Circuit in *Rockwell* v. *New York United Hotels*, 79 F. (2d) 81, certiorari denied *sub nom.*, *Donahue* v. *Rockwell*, 296 U. S. 650.

[4] The Board's findings (R. 6) and the stipulation (R. 14) indicate that the receivers were directed to receive the debentures and pay the debenture holders, but the order does not thus provide (R. 35–36).

$24,750) on June 22, 1934, and received $125 in cash for them (R. 6, 14, 38).

In his 1934 return the taxpayer attempted to deduct the difference between the cost of his debentures ($24,750) and the amount he received in final settlement ($125) as a bad debt. The Commissioner of Internal Revenue, in determining the deficiency, ruled that the transaction was governed by Section 117 (f) of the Revenue Act of 1934 and treated the amount in controversy as a capital loss subject to the limitations imposed by Section 117 (d) of the Act (R. 4).

The Board of Tax Appeals sustained the Commissioner's determination. The Circuit Court of Appeals reversed the Board, holding that there was no retirement of the debentures within the meaning of Section 117 (f), and that the transaction did not give rise to a capital loss but was governed by the bad debt provision of the statute. It remanded the case to the Board for proper findings under the latter provision.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the transaction shown by the record did not constitute a retirement within the meaning of Section 117 (f) of the Revenue Act of 1934 of the debenture bonds held by the taxpayer.

2. In failing and refusing to hold that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted

a capital loss subject to the limitations imposed by Section 117 (d) of the Revenue Act of 1934.

3. In holding that the loss resulting from the surrender and discharge of the debenture bonds held by the taxpayer constituted a bad debt deductible in full from gross income.

4. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The question as to whether the taxpayer sustained a capital loss which is deductible only to the extent provided in Section 117 (d) of the Revenue Act of 1934 depends upon whether the surrender of his debentures for cash in the course of the receivership and reorganization of the debtor corporation constituted a sale or exchange of capital assets within the meaning of Section 117 (d). The Government concedes that the transaction would not constitute a sale or exchange independently of Section 117 (f) since this Court has held that under statutes which contained no provision analogous to Section 117 (f), the payment of and discharge of a bond in accordance with the terms of the contract was not a sale or exchange and did not result in a capital gain or loss. Presumably the payment of a lesser sum than the amount due under the contract in discharge of the obligation would also fail to qualify as a sale or exchange. But Section 117 (f) changed the existing law.

That subsection provides in substance that for the purpose of the income tax title, amounts re-

ceived by the holder upon the "retirement" of corporate bonds, debentures, and other evidences of indebtedness shall be considered as amounts received in exchange therefor. If, therefore, the sum of $125 which the taxpayer received upon the surrender of his debentures was received upon their "retirement," the difference is to be treated as a capital loss.

The word "retirement" must be taken to have been used in its ordinary sense in Section 117 (f). The verb "retire" has been defined as meaning "to withdraw from circulation, to take up and pay." In the instant case, the debentures were withdrawn from circulation and taken up and paid when the taxpayer and other debenture holders were required to surrender their debentures and accept cash payments in full satisfaction of their debt so that the reorganization could proceed. Hence, there was a retirement within the literal meaning of Section 117 (f).

The term "retirement" is a broader term than redemption and the statute is not limited to cases where the debtor redeems the bonds in accordance with the terms of the contract. The legislative history of the provision shows that Congress chose the broader term deliberately and in an analogous case now before this Court another Circuit Court of Appeals applied it in a situation where no redemption occurred.

There is no foundation for the assumption made by the taxpayer and the court below that the statute

applies only where there is a voluntary discharge of the obligation by the debtor but not where the discharge is involuntary. The purpose of Congress in enacting Section 117 would not be given effect if such a distinction were made. The legislative history indicates that Congress intended to stabilize the revenue by preventing capital losses from being applied against ordinary income. It could achieve that purpose only by making Section 117 (f) apply where the conversion of corporate obligations into cash resulted from forced liquidations as well as from voluntary action on the part of the debtor. Moreover, from the standpoint of the bondholder or debenture holder, who is the taxpayer involved, the two transactions have the same aspect. In each there is a loss of capital investment, and there is no occasion to differentiate between the two situations.

The fact that Section 23 (k) (2) of the Revenue Act of 1938 changed the existing law so as to provide that losses sustained upon securities becoming worthless should also be treated as exchanges does not indicate that such a loss as the one here involved was not already embraced within Section 117 (f). Section 23 (k) (2) refers only to cases where the bonds retained by the taxpayer have become totally worthless.

The application of Section 117 (f) does not depend upon whether the amount received upon the retirement of securities is large or small. If it

applies to any case where bonds or debentures are surrendered for cash in a receivership proceeding it applies to all since the statute provides that "amounts received by the holder" upon the retirement of corporate bonds or other evidences of indebtedness shall be treated as having been received in exchange therefor. But, if an exception should be made in a case where the payment is purely nominal, this is not such a case.

Inasmuch as there was a "retirement," the transaction is to be treated as an exchange of capital assets giving rise to a capital loss rather than as a bad debt and the deduction is subject to the limitations of Section 117 (d).

ARGUMENT

THE TAXPAYER'S SURRENDER OF HIS DEBENTURES FOR CASH CONSTITUTED A RETIREMENT OF THE DEBENTURES WITHIN THE MEANING OF SECTION 117 (f) OF THE REVENUE ACT OF 1934 AND THE LOSS THEREBY SUSTAINED WAS A CAPITAL LOSS

1. *Introductory.*—In 1927 the taxpayer purchased debentures of the New York United Hotels, Incorporated, for $24,750. (R. 6). In 1934, pursuant to an order issued by the United States District Court for the Southern District of New York in the course of a receivership of the debtor corporation and a plan for its reorganization, the taxpayer surrendered his debentures to the new corporation acquiring the debtor's assets and received $5 for each $1,000 debenture surrendered

for cancellation, or a total of $125 (R. 6).[5] If, as the Government contends, and as the Board of Tax Appeals held, the difference of $24,625 between the cost of the debentures and the amount realized therefrom is a capital loss, the taxpayer is not entitled to deduct it for the reason that capital losses arising from other sources have already been allowed to the extent of the taxpayer's capital gains plus $2,000 (R. 4, 6–7), and no additional deduction for capital losses is allowable under Section 117 (d) (Appendix, *infra,* p. 35). If the difference is not a capital loss, it may be deducted as a bad debt under Section 23 (k) of the Revenue Act of 1934 (Appendix, *infra,* p. 34) if the requirements of that section are met.

That the debentures in controversy were capital assets is not disputed. The only question presented is whether there was a sale or exchange of such capital assets within Section 117 (d) which is expanded by Section 117 (f) to include "retirement" of corporate and Governmental obligations. If the transaction under review constituted such a "retirement," then the resulting capital loss is subject to the foregoing statutory restrictions. The same question is also before the Court in *McClain* v.

---

[5] The funds for this payment were furnished by the landlord of the debtor corporation after certain funds had been transferred to it by the receivers and the receivers had been discharged (R. 35–36, 37–38). In legal effect, therefore, the payment was made from the debtor's assets, and respondent has never contended otherwise.

Comissioner, No. 55, October Term, 1940, involving somewhat different facts, and the Court is referred to our brief in that case for a more complete statement of the legislative history of these provisions.

The Government concedes that in the absence of Section 117 (f), this transaction would not be a sale or exchange within the meaning of Section 117 (d). In *Fairbanks* v. *United States,* 306 U. S. 436 which arose under the predecessor provisions of the Revenue Acts of 1926 and 1928 (c. 27, 44 Stat. 9, Sec. 208; c. 852, 45 Stat. 791, Sec. 101), this Court held that the payment of or discharge of a bond in accordance with its terms was not a sale or exchange. Presumably the payment of a lesser sum than the amount due under the contract would also fail to qualify as a sa' or exchange. Those acts did not contain any provisions comparable to Section 117 (f) of the 1934 Act, here under review, which expanded the concept of sale or exchange to include retirement. Indeed, the Court in the *Fairbanks* case recognized that the new provisions, which it had no occasion to construe in that case, represented a material addition to existing law.

The instant case, therefore, presents a new issue, and turns upon the construction of Section 117 (f), which provides as follows:

> (f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evi-

dences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The court below held that the discharge of the taxpayer's debentures for cash in the receivership proceedings was not a retirement of the debentures within the meaning of Section 117 (f) on the ground that the word "retirement" signified some voluntary action on the debtor's part in fulfillment of his promise to pay and that in this case there was an extinguishment of the obligations rather than a retirement. The court, therefore, held inapplicable the capital loss provisions of Section 117, and determined that the case was one of a bad debt controlled by Section 23 (k) of the Revenue Act of 1934 (Appendix, *infra*, p. 34).

It is our position that in construing Section 117 (f) the court below unduly restricted the meaning of the word "retirement" and failed to give effect to the intention of Congress in enacting this provision.

2. The word "retirement" has no established legal meaning and must, therefore, be given its common and ordinary meaning. *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 327; *Old Colony Co.* v. *Commissioner*, 301 U. S. 379, 383. The verb "retire" is defined in Webster's New International

Dictionary (1939 Ed.), p. 2128, as meaning, among other things, "To withdraw from circulation, or from the market; to take up or pay; as, to *retire* bonds; to *retire* a note." The Century Dictionary and Cyclopedia (Revised Ed.), Vol. VIII, p. 5123, defines "retire" as meaning "To recover; redeem; regain by the payment of a sum of money; * * *." The latter definition was approved as applied to a note in *Empire Security Co.* v. *Berry,* 211 Ill. App. 278, and was accepted by the Circuit Court of Appeals for the Fifth Circuit in *McClain* v. *Commissioner,* 110 F. (2d) 878, now before this Court on writ of certiorari, No. 55, October Term, 1940, in construing Section 117 (f).

It is our position that the term "retirement" as thus defined covers all transactions by which bonds are surrendered for cash and discharged either by the debtor or one standing in the position of the debtor.

As employed in its ordinary sense, the word "retirement" is properly used to describe the transaction by which, in receivership or bankruptcy proceedings, the bondholders or debenture holders of a debtor corporation are required to surrender their bonds or debentures and accept cash payments in full satisfaction of their debt so that a reorganization may proceed. In such cases, when the securities are taken up and paid, there is actually a withdrawal from circulation in order to make possible the issuance of new securities by the

reorganized corporation. Accordingly, when Congress used the word "retirement" in Section 117 (f), we believe that it indicated its intention to have the statute apply to the type of transaction that is here involved.

If the word "redemption" rather than the word "retirement" had been used there might have been some basis for the court's conclusion that that section does not apply to the transaction in this case. A redemption has been defined as meaning "the payment of an obligation according to its terms" (*United States* v. *Fairbanks*, 95 F. (2d) 794 (C. C. A. 9th), affirmed, 306 U. S. 436; *Watson* v. *Commissioner*, 27 B. T. A. 463; *Braun, Trustee*, v. *Commissioner*, 29 B. T. A. 1161), and in this case the debentures were not taken up and paid in accordance with the original contract. But the statute employs the term "retirement," not the term "redemption," and while a retirement undoubtedly includes a redemption,[6] we submit that the former is the more inclusive term and that the court erred in holding that it did not apply to the instant case where securities were surrendered for cash in full discharge.

---

[6] That the two words are not the same is suggested by the fact that both are used under the reorganization provisions of the Bankruptcy Act in such manner as to indicate that Congress believed them to have different contents. See Act of June 22, 1938, c. 575, 52 Stat. 840, 895–897, amending Section 216 (12) (b) of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended.

3. Although the reports of the Senate Committee on Finance and the Committee on Ways and Means of the House of Representatives do not reveal precisely what meaning Congress attributed to the word "retirement" in Section 117 (f) of the Revenue Act of 1934 (see H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10; S. Rep. No. 558, 73d Cong., 2d Sess., pp. 11–13), the legislative history does disclose that the choice of the word "retirement" was deliberate. The Committee on Federal Taxation of the American Bar Association had recommended to the Committee on Ways and Means of the House that the existing law be amended to make it clear that the definition of capital gains and losses include gains or losses arising from redemption of capital assets. House Hearings before the Committee on Ways and Means on Revenue Revision, 1934, 73d Cong., 2d Sess., pp. 190–191.[7] The substitution

[7] A suggestion that the definition of capital gain and capital loss be changed so as to make it clear that it included gain or loss from "the redemption or retirement of corporate securities" had been made by Arthur A. Ballantyne, Chairman of the Committee on Taxation of the Association of the Bar of the City of New York, during the hearings before the Committee on Finance, United States Senate, on the Revenue Bill of 1928 (Hearings before the Committee on Finance, United States Senate, on H. R. 1, 70th Cong., 1st Sess., pp. 295, 297), but was not adopted. The Board subsequently held in *Watson* v. *Commissioner*, 27 B. T. A. 463 (decided in December 1932) and *Braun, Trustee* v. *Commissioner*, 29 B. T. A. 1161 (decided in February 1934), that payments of the amounts specified in a bond either at maturity or pursuant to an authorized call

of the word "retirement" for "redemption" in the statute as finally enacted suggests, therefore, that Congress deliberately chose a more comprehensive word.

It should also be remembered that when Congress enacted the Revenue Act of 1934 the Board of Tax Appeals had decided *Watson* v. *Commissioner*, 27 B. T. A. 463. That case involved a taxpayer who had purchased Liberty bonds at a premium and had realized a loss when the bonds were paid at maturity. The Board held that the loss was not a capital loss for the reason that payment of the amounts specified in bonds either at maturity or pursuant to an authorized call prior to maturity was not a sale or exchange within the meaning of the statute there involved but merely constituted a satisfaction of the obligation by payment. If Congress had intended simply to overcome the effect of the decision in the *Watson* case, it could have done so by using the word "redemption" in the statute. It would then have been clear that only the discharge of an obligation according to its terms was to be treated as an exchange of capital assets. But when Congress chose the broader term "retirement" it must have intended to cover all cases in which an obligation is discharged by payment.

---

prior to maturity did not constitute a sale or exchange. It thereby reversed an earlier decision, *Werner* v. *Commissioner*, 15 B. T. A. 482. It was undoubtedly those decisions which led to the enactment of Section 117 (f) of the Revenue Act of 1934.

Moreover, there would be no sound reason for drawing such a distinction. In each situation there is actually a loss of capital investment, and it should make no difference how the discharge of the obligations occurred. It seems hardly likely that Congress could have intended two loss-producing transactions, essentially similar from the taxpayer's point of view, to be treated differently for tax purposes.

That was apparently the view taken by the Circuit Court of Appeals for the Fifth Circuit in *McClain* v. *Commissioner*, 110 F. (2d) 878, now pending before this Court on certiorari, No. 55, October Term, 1940. In that case, the court held that Section 117 (f) did apply to a situation where bonds were retired by the debtor corporation otherwise than in accordance with the terms of the agreement. There, a water improvement district, a political subdivision of the State of Texas, defaulted on the payment of both principal and interest of its bonds. After having sought municipal bankruptcy in vain, it applied to the Reconstruction Finance Corporation for a loan. That agency agreed to lend only enough to pay 49.9% of the principal of the bonds and as a condition of the loan required that the bondholders deposit their bonds with a committee to be cancelled upon payment of the reduced amount. The court held that the deposit of the bonds for surrender and their surrender for cancellation on payment by the district of the

agreed sum was a retirement of the bonds within the meaning of Section 117(f). *Corbin* v. *Commissioner*, 39 B. T. A. 1163, is to the same effect.

It is clear that the *McClain* case and the case at bar both involve a situation where the discharge of the obligations was not made in accordance with the terms of the original contract. In a strict sense, there was no redemption of the bonds in either case, and we believe that there are no differences of fact that are material.

It is true that in the *McClain* case the municipal corporation was unable to declare itself a bankrupt and, therefore, resorted to a Reconstruction Finance Corporation loan which enabled it to discharge its bonds and resume its operations, whereas in the instant case the debtor corporation went into a receivership and the bonds were discharged by payments from the debtor's assets. On the basis of the difference in facts the taxpayer apparently concedes (Br. in Op., p. 4) that there was a retirement in the *McClain* case because there was a voluntary discharge of the debt by the debtor but argues that such is not the situation here.

It may be argued, however, that in the *McClain* case, as in the instant case, the transaction was not voluntary in any real sense. The debtor, a municipal corporation, would have declared itself a bankrupt had it been legally possible for it to do so. When that was found impossible, the district resorted to other means of ridding itself of its bonded indebtedness.

4. But even if the transaction in the *McClain* case were considered a voluntary transaction, and the transaction here an involuntary one, we submit that there is no foundation for the assumption made by the taxpayer and by the court below that the statute draws a distinction between a case where there is a voluntary discharge of the obligation by the debtor and one where the discharge is involuntary.

Under earlier statutes this Court held, in the *Fairbanks* case, *supra,* that a redemption of bonds prior to maturity did not constitute an exchange of capital assets because it represented a discharge of the debt and not because the transaction was involuntary from the standpoint of the debtor. Clearly there would have been no basis for the latter holding, for a redemption is voluntary from the debtor's standpoint. The more reasonable assumption, therefore, is that in enacting Section 117 (f) Congress sought to extend the operation of the capital gain-and-loss provisions to all discharges of securities effected by cash payments, whether voluntarily or involuntarily made. All such transactions represent a conversion of the assets into cash and thus bear a close resemblance to conversions effected by a sale. There would be no reason for treating voluntary and involuntary transactions differently for tax purposes.

Moreover, the purpose of Congress in enacting Section 117 would not be given effect if such a

distinction were made. The Revenue Act of 1934 made fundamental changes in the treatment of capital gains and losses. Prior to 1934 different rates of tax applied to capital net gains and capital net losses of individuals (see Section 101 of the Revenue Act of 1932, c. 209, 47 Stat. 169), and there was no segregation of the capital gains and losses of corporations. The effect of Section 117 of the 1934 Act is that both for individuals and corporations capital gains and losses are treated as other income or deductions in computing taxable net income, but the amount of the gain or loss to be recognized and taken into account for that purpose is subject to certain limitations.

The first limitation, imposed by Section 117 (a), applies only to individuals. Capital gain or loss is to be recognized only in certain percentages dependent upon the length of time that the asset has been held, the highest percentage applying to the asset held for the shortest time. The second limitation imposed by Section 117 (d) and applicable to individuals and corporations alike limits the deduction of capital losses to an amount not in excess of the capital gains plus $2,000. One of the purposes of both provisions, and particularly of Section 117 (d), was to achieve more stability in the revenues by preventing ordinary taxable income from being diminished by capital losses. See H. Rep. No. 704, 73d Cong., 2d Sess., pp. 9–10, 30–32, and statement on the Senate Floor by Chair-

man Harrison of the Senate Finance Committee (Cong. Record, Vol. 78, Part 6, p. 5846).

If Congress meant to stabilize the revenue, it must have intended Section 117 (f) to apply where the conversion of obligations into cash resulted from forced liquidations as well as from voluntary action on the part of the debtor; for 1934 was a year of depression and much forced liquidation of capital was taking place.

There are three types of situations in which a taxpayer may realize a loss upon corporate or government obligations, namely, (1) a disposition of the securities by a sale or exchange, which involves a transaction with a third person, (2) a surrender of the securities to the debtor or someone standing in the position of the debtor for cash, and (3) the securities becoming worthless, which does not involve any transaction with anyone. The first two of these situations, but not the third, could also give rise to a gain.

Under the statutes prior to 1934, only the first situation, namely, a disposition of the securities by a sale or exchange was covered by the capital gain and loss provisions. In a transaction which resulted in the surrender of the securities and the payment of cash, but involving the creditor and debtor only, there was not a sale or exchange.

It is obvious that from the point of view of taxation, there had never been any reason, apart from the controlling language of the statute, for treating

differently the various types of losses which a taxpayer sustains on investments in corporate and government bonds or similar evidences of indebtedness. The practical consequences to the bondholder are the same whether his loss is sustained (1) by selling the bonds to a third person, (2) by surrendering them to his debtor, or someone standing in the debtor's position, for cash, whether in pursuance of the original contract or otherwise, or (3) by having them become worthless on his hands. The second situation, however, more closely resembles a sale than does the third, since in both cash is received and the securities are disposed of.

It is our position that when Congress enacted Section 117 (f) of the Revenue Act of 1934, it intended to cover all transactions coming within the second class. It is logical to assume that this was its intention because of the resemblance which these transactions bore to sale, because of the language of the statute itself, which requires that "amounts received upon retirement" of such obligations shall be treated as having been received in exchange therefor, and because, as we subsequently point out, in enacting the Revenue Act of 1938, Congress dealt separately with the third class of cases, namely, those involving a situation where the securities had become totally worthless.

We submit that there is no basis for the assumption that Congress intended that amounts received

in discharge of obligations by the debtor should be treated as an exchange, but that amounts received in discharge of an obligation effected in some other manner should not be so treated.[8] Neither would constitute an exchange independently of Section 117 (f) and if Congress meant to treat one as an exchange it no doubt meant to treat both as exchanges. From the standpoint of the bondholder or debenture holder, who is the taxpayer involved, the two transactions have the same aspect. Moreover, both transactions resemble transactions resulting in a conversion of stocks of a corporation into cash upon a liquidation, the loss on which was already treated as a capital loss for tax purposes.[9] Congress undoubtedly intended that the investor in stocks and the investor in corporate bonds and other evidences of indebtedness should be treated similarly for tax purposes.

The taxpayer will probably renew his contention made below that if Congress had intended to classify a loss like his as a capital loss rather than as a

---

[8] In *Commissioner* v. *Hammel*, No. 49, October Term, 1940, and *Electro-Chemical Engraving Co.* v. *Commissioner*, No. 62, October Term, 1940, the taxpayers are contending that Section 117 applies only to sales which are voluntary sales by the taxpayers and does not apply to foreclosure sales of the taxpayer's property. It is our position in those cases as here that the application of the statute does not depend on the voluntary or involuntary character of the transaction.

[9] See *White* v. *United States*, 305 U. S. 281; *Helvering* v. *Weaver Co.*, 305 U. S. 293.

bad debt, it would have found no difficulty in saying so, and that it did thus classify such losses in Section 23 (k) of the Revenue Act of 1938, c. 289, 52 Stat. 447.

Section 23 (k) (2) of the Revenue Act of 1938 provides that if securities (defined in Section 23 (k) (3) as including bonds, debentures, notes, certificates, or other evidences of indebtedness issued by private or governmental corporations with interest coupons or in registered form) are ascertained to be worthless and charged off within the taxable year and are capital assets, the loss resulting therefrom shall, except in the case of a bank, be considered as a loss from the sale or exchange of capital assets on the last day of the taxable year. It will be noted that this section in terms relates solely to securities which become wholly worthless and are charged off during the taxable year. It is similar to Section 23 (g) (2) and (3) relating to worthless stock and stock rights. It does not specifically apply to a situation where bonds are surrendered in consideration of a cash payment in a receivership and reorganization proceeding and the legislative history does not disclose that Congress had such a situation in mind. The Committee Reports indicate that Congress intended this provision to apply only to securities retained by the taxpayer, which were determined to be totally worthless. See H. Conference Rep. No. 2330 on the Revenue Bill of 1938, 75th Cong., 3d Sess., p. 35. See also

Report of Subcommittee of the Committee on Ways and Means on a Proposed Revision of the Revenue Laws, 75th Cong., 3d Sess., pp. 44–46.

The Treasury Department Regulations have construed this section as being applicable only to such a situation. See Article 23 (k)–4 of Regulations 101, promulgated under the Revenue Act of 1938. Section 23 (k) (2), therefore, does not refer to a situation where the bondholder surrenders his bonds for cash in a reorganization proceeding.

It would be clearly unreasonable, however, to assume that Congress intended losses sustained upon wholly worthless securities to be treated as exchanges, while at the same time according different treatment to losses upon securities discharged by cash payments in a receivership. It undoubtedly thought that the latter situation was taken care of by Section 117 (f) of the Revenue Act of 1938 which is identical with Section 117 (f) in the Revenue Act of 1934, here involved. *In other words, Section 117 (f) covered all transactions (other than actual sales or exchanges) by which bonds, debentures, or similar evidences of indebtedness were converted into cash, even though the effect of the transaction was merely to discharge the debt and there was no sale or exchange in a technical sense, and Section 23 (k) (2) covered all situations where such securities were still held by the taxpayer but had become totally worthless,* even though there was neither an exchange nor a conversion into cash.

Congress must have intended to bring both transactions within the operation of the capital gain and loss provisions, since the former, which results in the receipt of cash, more clearly resembles and more nearly has the effect of an exchange or sale, and must, therefore, have believed that the former was included under Section 117 (f). And if that is the meaning of Section 117 (f) of the Revenue Act of 1938, it is also the meaning of Section 117 (f) of the Revenue Act of 1934, for the two provisions are identical.

5. The court below apparently thought that the bad debt provisions of the Revenue Act of 1934 rather than the capital loss provisions were applicable, both because the regulations issued under the former refer to bankruptcy proceedings as establishing the worthlessness of debts and because the amount received in satisfaction of the debentures in this case was so small—only ½ of 1%.

The regulation to which the court referred is Article 23 (k)–1 of Regulations 86, promulgated under the Revenue Act of 1934, which does not relate specifically to bonds but which, in reference to bad debts generally, lays down the following rule:

> * * * Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the

> debt for the purpose of deduction. Bankrutcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. * * *

The Government does not deny that bonds have been treated as debts within the meaning of the bad-debt provisions of the Revenue Act of 1934 and previous statutes. *Pacific Nat. Bank* v. *Commissioner,* 91 F. (2d) 103 (C. C. A. 9th); *Commonwealth Commercial State Bank* v. *Lucas,* 41 F. (2d) 111 (App. D. C.); *Lebanon Nat. Bank* v. *Commissioner,* 76 F. (2d) 792 (C. C. A. 3d). But the above regulation appears to be applicable only to unsecured and unpreferred debts. It should be noted that another regulation, Article 23 (k)–3, refers to cases where there is an uncollectible deficiency upon the sale of mortgaged or pledged property and that Article 23 (k)–4 (*Appendix, infra,* p. 36) is the only regulation dealing with bonds. That regulation refers to two situations: (1) Where there is a foreclosure sale of property

securing bonds of an insolvent corporation from which nothing is realized for the bondholders, in which case the total basis is allowable as a bad debt; and (2) where the bondholder ascertains that due to the financial condition of the debtor bonds he holds will not be paid at maturity, either in whole or in part, in which case all or a part of the cost of the bonds is deductible as a bad debt.

We submit that this regulation which is merely a restatement of regulations issued under earlier statutes (see Article 191 of Regulations 77, promulgated under the Revenue Act of 1932) presents no obstacle to a holding that the capital-loss provisions rather than the bad-debt provisions of the Revenue Act of 1934 are applicable to this case where the bonds were discharged for cash in a receivership proceeding. Article 23 (k)-4 relates to a situation where bonds retained by the taxpayer are ascertained to be worthless in whole or in part prior to maturity and do not specifically refer to a situation where corporation bonds are surrendered for cash in a receivership proceeding. At best, the regulation is ambiguous. It may relate only to bonds which do not constitute capital assets as defined in Section 117, and hence do not come under Section 117 (f). Probably it was intended to govern obligations not otherwise removed from the operation of the bad-debt provisions by such specific provisions relating to capital losses as are contained in Section 117. In any event, it fails to disclose

that the Treasury Department has treated a discharge of bonds for cash in a receivership as falling under the bad-debt provisions rather than under the capital-loss provisions of the Revenue Act of 1934. As the Board of Tax Appeals suggested in *Corbin* v. *Commissioner*, 39 B. T. A. 1163, the regulation in question throws no light on the proper construction of Section 117 (f). The latter section provides that "For the purpose of this title," amounts received on the retirement of corporate securities are to be treated as amounts received in exchange for such securities. Section 117 (f), therefore, obviously limits the application of the bad-debt provisions to situations which are not embraced within that section.

Section 117 (f) deals specifically with the retirement of bonds. And under the well-established rule of construction that a specific provision prevails over a general provision which otherwise might apply (*Missouri* v. *Ross*, 299 U. S. 72; *Ginsberg & Sons* v. *Popkin*, 285 U. S. 204; *United States* v. *Chase*, 135 U. S. 255; *Hellmich* v. *Hellman*, 276 U. S. 233), Section 117 (f) controls if there was a retirement of the bonds, even though Section 23 (k) might otherwise be applicable. The regulations interpreting Section 23 (k) cannot bring and were not intended to bring within the operation of the general provisions of that section transactions which come under Section 117 (f).

There are no Treasury Regulations construing Section 117 (f) itself.[10] Article 117–4 (Appendix, *infra,* p. 37), which relates to the application of Section 117 generally, does not contain any reference to Section 117 (f) and merely provides that since the section relates to gains and losses from the sale or exchange of capital assets, it does not apply to losses sustained as the result of stock or debts becoming worthless. Insofar as the limitation may be said to refer to corporate bonds, it clearly refers to a situation where the bonds have not been disposed of but have become worthless.

There is a suggestion in the opinion of the court below that the bad-debt provisions rather than the loss provisions apply for the reason that the amount received, ½ of 1% of the face value of the obligations, was very small. But if Section 117 (f) applies to any case where bonds are discharged in a receivership by the payment of cash, it must apply to all such cases. The provision requires that "amounts received by the holder" upon the retirement of bonds and other evidences of indebtedness issued by a corporation shall be considered as amounts received in exchange therefor; therefore, if any amount is received, however small, it comes within the literal language of the statute.

---

[10] There are also no regulations interpreting Section 117 (f) of the Revenue Acts of 1936 and 1938, and there are very few Bureau rulings in point. See I. T. 2986, XV–1 Cum. Bull. 136; I. T. 3121, 1937–2 Cum. Bull. 138.

Cf. *White* v. *United States*, 305 U. S. 281; *Powell* v. *Kyle* (E. D. Pa.), decided February 10, 1938, not officially reported, but may be found in 1938 C. C. H., Vol. 4, ¶ 9104. But even if it should be held that the capital-loss provisions do not apply where a purely nominal amount was received, we do not believe that the sum received here, $125, is such an amount.

It may also be argued that to permit a bondholder or debenture holder who receives nothing in a receivership proceeding to claim a bad-debt deduction and to deny a similar deduction to one that realizes a small fraction of his principal is unreasonable and inequitable and that for that reason Section 117 (f) should be held not to apply to this case. But Section 117 (f) is clear and an exception may not be engrafted on its unambiguous language. Cf. *Crooks* v. *Harrelson*, 282 U. S. 55.

A somewhat analogous situation was presented in *Echols* v. *Commissioner*, 61 F. (2d) 191 (C. C. A. 8th), which involved the question whether a stockholder who had received no distribution in the liquidation of a bankrupt corporation was entitled to treat the loss on his investment as a capital loss under Section 208 of the Revenue Act of 1928. Section 201 (c) of that Act provided that amounts distributed in complete or partial liquidation from a corporation should be treated as a payment in exchange for the stock. The taxpayers argued that to construe this statute as meaning that a

stockholder who realized some minute amount in liquidation had sustained a capital loss and that a stockholder who had received nothing had not was to reach an absurd result and consequently that the statute should be construed to include both transactions. But the court rejected that argument, holding that the language was unambiguous and that it did not cover a case where no amounts were received. See also *White* v. *United States*, 305 U. S. 281.

Conversely in this case Section 117 (f) applies to all amounts received by the holder of securities upon their retirement, without making any exception with respect to small payments, and the fact that the capital loss provisions would not apply if no amount had been received does not justify the holding that they do not apply where the amount received was small.

We submit, therefore, that there was a "retirement" of the taxpayer's debentures within the meaning of Section 117 (f) and, hence, that the resulting loss is a capital loss subject to the limitations of Section 117 (d).

If, however, the Court should hold that the case is one for a bad-debt deduction under Section 23 (k), we call attention to the fact that the Board made no findings of fact as to whether or not the debt was ascertained to be worthless and charged off during the taxable year. In the absence of such findings, it cannot be assumed that a deduction is

allowable under that section and, as the court below held, the case should be remanded to the Board for further findings.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
HELEN R. CARLOSS,
Special Assistants to the Attorney General.

OCTOBER 1940.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. (U. S. C., Title 26, Sec. 101.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (k)-4. *Worthless bonds and similar obligations.*—Bonds, if ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. If a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncol-

lectible part of the debt evidenced by the bonds or other similar obligations.

* * * * *

ART. 117–4. *Application of section 117 generally.*—Section 117 applies only to gains and losses upon the sale or exchange of capital assets and, therefore, has no application to loss of useful value upon the permanent abandonment of the use of property (see article 23 (e)–3), or loss sustained as the result of corporate stock or debts becoming worthless.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1940